BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

GEORGIA M. KUVALIS AND LEWIS H. JOHNSON, EXECUTORS OF THE ESTATE OF PETER N. KUVALIS, AND GEORGIA M. KUVALIS, INDIVIDUALLY

Appearances:

For Appellants: Archibald M. Mull, Jr, Attorney at Law

For Respondent: F. Edward Caine Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Georgia M. Kuvalis and Lewis H. Johnson, Executors of the Estate of Peter N. Kuvalis, and Georgia M. Kuvalis, individually, against proposed assessments of additional personal income tax in the amounts of $264.46, $533.05, and $145.70 for the years 1953, 1954, and 1955, respectively.

During the years in question, Peter N. Kuvalis (now deceased) was a partner in Royal Novelty Company, which operated a coin machine business in San Francisco. The business owned pinball machines which were placed in various locations such as bars and restaurants. Approximately 70 percent of the machines were bingo type pinball machines; the other 30 percent were flipper type machines. The proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between Royal Novelty Company and the location owner.

The gross income reported in the partnership tax returns for each year was the total of machine proceeds retained by the partnership. Deductions were taken for depreciation of the machines and other business expenses. Respondent originally determined that the partnership was renting space in the locations where its machines were placed and that all of the coins deposited in the machines constituted gross income of the partnership. Respondent also disallowed all expenses connected with the pinball business, pursuant to section 17359 (now section 17297) of the Revenue and Taxation Code, That section provided:

> In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

As a result of the decision in Hall v. *Franchise* Tax Board, 244 Cal. App. 2d 843 [53 Cal. Rptr. 597], respondent has reduced the original assessments to reflect its concession that the partnership was engaged in a joint venture with each location owner and was not merely renting space from each owner. Respondent has also inferred from Hall that former section 17359 should not be used to deny deductions for expenses shown to be attributable to the legal activities of the business. From information obtained from sources other than the appellants, respondent determined that 40 percent of the expenses claimed by the partnership were attributable to legal business activities and thus were deductible, Accordingly, respondent now concedes that appellants have no additional tax liability for 1955 and that their additional liabilities for 1953 and 1954 are $64.93 and $82.25, respectively.

On the basis of the evidence adduced at the hearing we find that the relationship between the partnership and each location owner was a joint venture and that some cash payouts were made for free games won by players of the machines. There is also no question that the partnership's *ownership* of bingo type pinball machines was illegal under Penal Code section 330.1. (Appeal of Advance Automatic Sales Co., Inc., Cal. St. Bd. of Equal., Oct. 9, 1962.) Consequently, former section 17359 of the Revenue and Taxation Code clearly applies to deny appellants

any deductions for their share of the partnership's expenses in producing the income from the illegal machines. Although appellants made no attempt to show what portion of the partnership's total expenses were attributable to legal activities, respondent has computed that figure at 40% and has reduced the proposed assessments accordingly. In our opinion appellant3' true tax liability is certainly no less than respondent's revised figures, and it may well be greater. Under the circumstances, however, we will accept respondent'-s figures.

All of appellants' arguments were disposed of long ago in the Appeals of C. B. Hall, Sr., et al., Cal. St. Bd. of Equal., Dec. 29, 1958, and in the Appeal of George and Louise Arnerich, Cal. St. Bd. of Equal., May 25, 1960. It would serve no useful purpose to discuss matters so well settled.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Georgia M. Kuvalis and Lewis H. Johnson, Executors of the Estate of Peter N. Kuvalis, and Georgia M. Kuvalis, individually, against proposed assessments. of additional personal income tax in the mounts of $264.46, $533.05, and $145.70 for the years 1953, 1954, and 1955, respectively, be and the same is hereby modified in accordance with respondent 's concessions. In all other respects, the action of the Franchise Tax Board is sustained,

Done at Sacramento, California, this 14th day of September , 1972, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary